

December 15, 1982

LETTER 850

Dec. 3, DJIA 1031.36; PTI 1389; A-D Ratio -19.43
Dec. 10, DJIA 1018.76; PTI 1391; A-D Ratio -19.50

THE MARKET: On December 6 the market advanced sharply. Transports gained 13.71 to close at a new record high of 459.08 (see page 1 chart). The Industrial Average, although rising 24.29 points, *failed to confirm* in that Industrials closed 10 points short of their own record high of 1065.49 (the 1065.49 high was recorded on Nov. 3, 1982).

The new Transport high presents the market with the problem of a *primary non-confirmation*, a non-confirmation which will be erased if or when Industrials better their 1065.49 peak. If there is to be trouble, if there is to be a full correction, this would be the strategic time for it to begin.

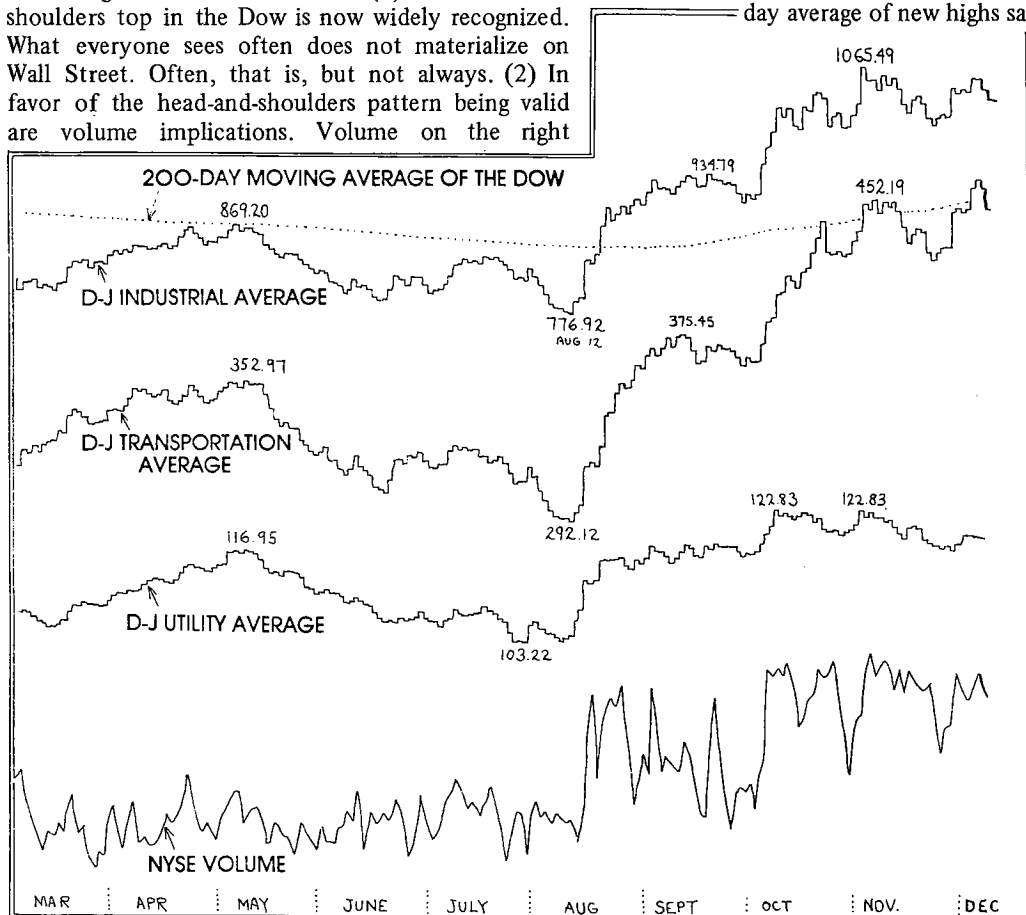
In the last Letter I drew attention to the "head and shoulders" top formation in the Industrial Average. I noted that the main support for that pattern comes in at approximately 980 on the Dow. A breaking of 980 would therefore be the signal for a full correction of the entire move since August 12.

Following the primary non-confirmation (as described above), we have seen the market turn weak, and we have witnessed the D-J Industrials drop into the 1020s area. But whether enough weakness will be generated to crack the 980 support level remains to be seen.

Following are a few comments: (1) The head-and-shoulders top in the Dow is now widely recognized. What everyone sees often does not materialize on Wall Street. Often, that is, but not always. (2) In favor of the head-and-shoulders pattern being valid are volume implications. Volume on the right

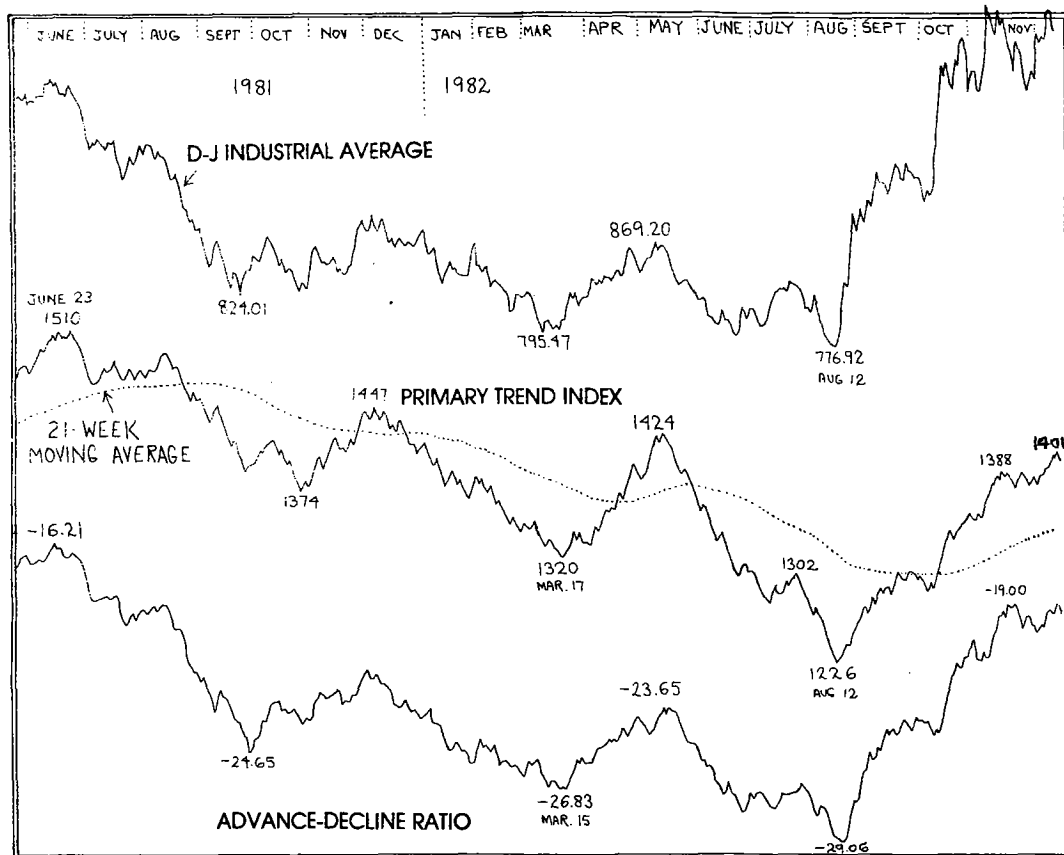
FRONT PAGE COMMENT: Over the weekend I had this thought: "In the quarter century that I've been writing about the markets, I've never seen the future look so cloudy, so confused." And I ask myself, "What, if anything, seems *sure* in the period ahead? Here are my answers: (1) The standard of living in the US and the rest of the world will be heading down. I'm convinced of this. We've mortgaged the future to provide today's standard of living, and the mortgage is close to being called. (2) Huge credits will be extended in dozens of areas—all in an effort to keep the world "afloat." (3) Business will become more competitive as the various nations fight to hang onto their markets. (4) The concept of entitlements, liberal welfare and government largesse will face its biggest test of the century (remember, these concepts have never been tested in a period of high debt and deflationary forces.) (5) The Reagan people, pressed to the wall by ghastly deficits, will continue to seek higher taxes in almost every conceivable nook and cranny—from gasoline to health benefits, from unemployment payments to . . . who knows what else.

shoulder (at the December highs) fell off noticeably. Also in favor of the top being valid are the new high statistics. My 5-day average of daily new highs hit a peak of 438 in October at the left shoulder, the 5-day average dropped to 393 in November (at the head with the Dow at a record 1065.49). During the December high (with the Dow within 10 points of its record high) the 5-day average of new highs sank to 210!



In 1971 (after many years of experimenting) I developed an indicator which I named the Primary Trend Index (PTI). What I was looking for was an indicator which would weigh, on a daily basis, the build-up or deterioration in the technical strength of the market. It took me ten years to accumulate a workable body of data on the PTI. And it took me considerably longer to really put my faith in this instrument. But with each year that goes by I have learned and re-learned the importance of the simple rule, "Stay on the right side of the PTI."

Turning to the daily chart of the PTI, note that the PTI recorded a low of 1226 on August 12, then turned up. In early October the PTI rose above its 21-week moving average. With the trend bullish, the PTI then climbed to a November 9 high of 1388. Following the November 9 peak, the market sold off while



INVESTMENT POSITION:

Sometimes I think I should drop all fundamental and technical considerations and simply put my money on the trend of the PTI. It might not be as interesting as the more intricate analysis I now present—but it could be less wearing and it could also be more profitable.

So far, I have operated on the thesis that the *safest* time to buy is at the bottom of the first full correction in a new bull market. The decline down to the Dow 990.00 low of November 23 is what I would term a minor correction, but so far there has been no full correction in this market. Nevertheless, a full correction will be forthcoming—perhaps before 1982 is out. When it finally arrives, it will probably be more severe than anything most people are prepared for.

Our simple investment position is as follows: 15% to 20% in

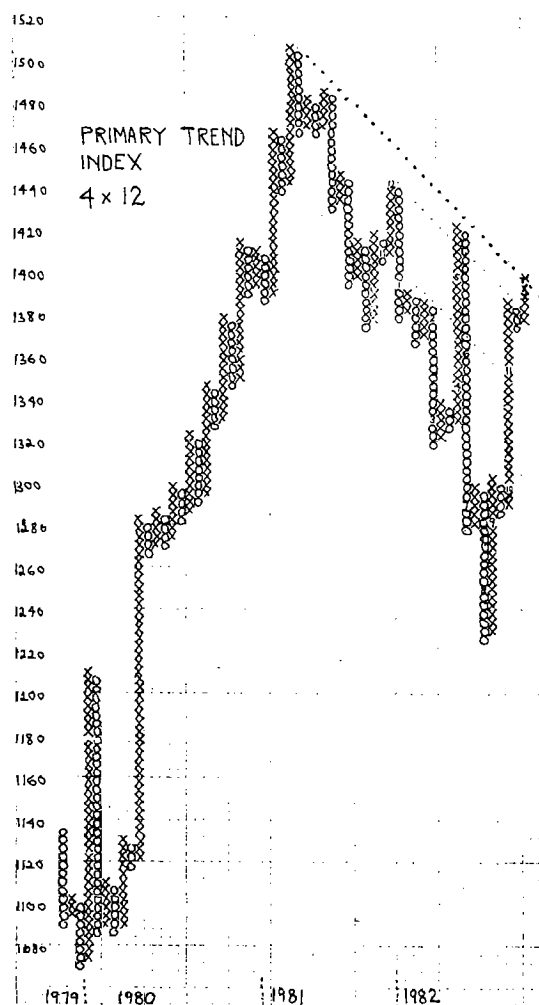
the Dow dropped to a November 23 low of 990.99. During this sell-off the PTI showed dramatic resistance to decline. By December 3 the PTI had rallied to a new recovery high of 1390. On December 6 the Dow exploded, advancing 24 points to 1055.65.

My long-time rule for PTI followers is, "You can skip a move on the PTI—but never be on the wrong side of the PTI." Obviously, the short sellers have been on the wrong side of the PTI ever since mid-August, and this has resulted in the single worst tragedy in investing—a major loss of capital.

What of the PTI now? If you draw a trendline connecting the August and September lows in the PTI, it is clear that the PTI would have to penetrate the 1380 level in order to turn bearish. On a somewhat longer-term basis, the 21-week MA of the PTI now stands at 1343. If the PTI were to break and hold below 1343, its trend would be re-confirmed as bearish.

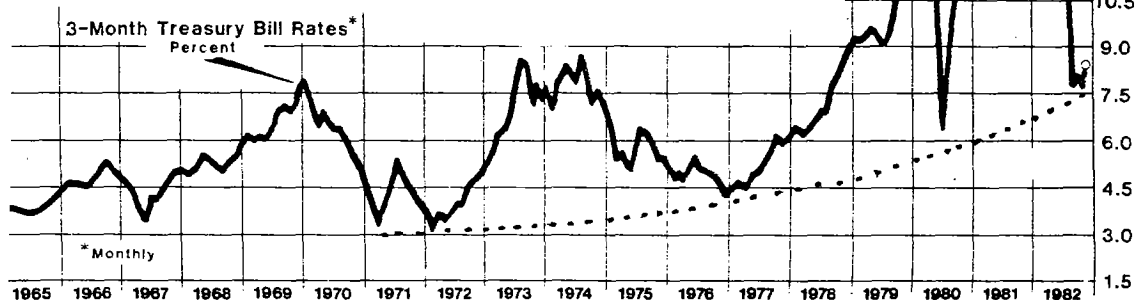
At the bottom of the chart note that the advance-decline ratio recorded its high on November 11 at minus 19. Following that peak, the A-D broke its rising trend, and the first signs of weakness are therefore seen in the general market as characterized by the A-D ratio.

To clarify the longer-term trend of the PTI I am again including my point & figure chart of this instrument. Note that the latest PTI action has advanced the PTI to exactly its long-term bearish trendline. On this chart, a reading of 1372 would be required to turn the PTI bearish. But the fact is that there has been no real weakness in the PTI since the August 12 low. However, I feel the PTI could come in for a test over the next few months.



gold related items (i.e., Campbell Red Lake and ASA plus gold coins). Another 25% should be in 5-10 year Treasury notes. In the first full correction, I will recommend putting possibly up to half our assets into no-load stock funds, but for the time being this money is in Treasury bills.

There are any number of excellent no-load funds, but a few that I like now are Columbia Growth Fund (800) 547-1037. Fidelity Select Technology Portfolio (800) 225-6190. Explorer Fund (800) 523-7910. Lindner Fund (314) 727-5305.



INTEREST RATES: With everybody mesmerized by predictions of “lower interest rates into 1983-84,” it’s interesting to note what has actually been happening. This long-term chart (courtesy S & P’s The Outlook) shows the path of 91-day bill yields going back to 1965. The low for the yields was recorded in early-1972. Since then each decline in bill yields has bottomed out at a HIGHER level.

The most interesting low is really the 1982 low. The fact is that the 91-day T-bills hit their low yield of 7% on August 20. Since then the yields have been climbing slowly to or around the 8% level. But the important thing is that the bill yields have climbed despite every effort by the Fed to bring them down and hold them down.

So the question is, “Why have the T-bills, in the face of the worst recession in almost 50 years, been so reluctant to break to new lows?” And I believe the answer is that the money markets are sensing the huge inflationary potential in the hundreds of billions of dollar credits being extended by the US Government, the World Banks, the IMF, the BIS, and the various banks in the US. Never mind that this is throwing good money after bad, the fact is that the effect is potentially inflationary. If one measured number of dollar credits and loans against each existing ounce of gold, we would get a chart that ran off the top of the page. In an effort to “hold up the world,” the dollar is being overworked. It is being asked to do too much. And probably the best barometer of the situation is the price of dollars in terms of gold.

My own feeling is that as dollar loans are in a bull market, so is the price of gold in terms of dollars. My guess is that as or when gold goes over 490-500, the bond market is going to start sliding in earnest. Everything we see so far in the rising T-bill yields is merely a base for the next “take-off” in interest rates. Gold over 500 will place the money market, I feel, on the edge of panic.

THINGS TO COME: (1) Europe and Britain are now in the grip of a severe recession. Unemployment across Europe and Britain are at post-war highs. But their economic and social systems are brittle. Entitlements, welfare and unemployment compensation systems have been built into Europe and Britain,

and the costs of those systems is almost prohibitive. As the recession lingers on, as tax receipts to the various governments decline, the deficits build up. To make matters worse, Europe and Britain are not competing successfully in world markets. This intensifies their trade deficits and is leading toward trade barriers.

(2) Add to this the dismal picture in Central and South America and you have the picture of a world drowning in debts, deficits and credits. With still more deficits to come. The process appears endless. The fact is that the governments of most of the developed nations are committed to a policy of “the people shall feel no pain” in the face of recession. But if you insist on avoiding pain, then you have to hand out a lot of money. And to hand out money you haven’t got means deficits and more borrowing. That’s the BIG picture in the world today.

(3) In the face of the billions of dollars of new credits now being extended to nations across the world, gold is moving up. There are two sides of the gold picture. The bear side is obvious, but the bull side is more obscure.

The bear side is simple: there is little inflation today, so why buy gold? The bull argument is as follows: the massive building of dollar credits and debts constitutes a great inflation potential. Or, to put it another way, there are more and more dollars accumulating against every existing ounce of gold.

(4) Gold has been slowly, but relentlessly, moving up from its June low of 297. If gold breaks above 500 I think the move is going to start panicking the money markets (“inflation is back again”). In that case bonds will be coming down with a vengeance (while long-term interest rates will be heading up). This will put a damper on the stock market, thrusting it into a trading range of perhaps 800 to 1080.

(5) A concerted decline in the bond market (driving interest rates higher) would act as a depressant on the already fragile economy. This will mean that the long-awaited “recovery” will stall out. And in the face of sub-standard tax receipts to government the federal deficits will grow larger than ever (well above \$200 billion in 1983). This too will serve to drive interest rates higher, as record government deficits swamp the money markets.

(6) The oil price structure has cracked, but now (in the face of a world-wide oil glut) it is close to caving in. A major slide in oil prices would reduce costs in many energy-intensive industries. But it is also well to note that billions of dollars are out on loans against high-priced oil. Any dramatic slide in oil prices would put these loans in jeopardy (as well as the banks that made the loans). Moreover, a big slide in oil prices would possibly bankrupt some of the oil producing nations (Mexico is a perfect example, Libya is another).

(7) The fact is that the world over the last five years has geared up to high-priced oil and a fat standard of living based on inflationary expectations. If oil prices come down hard, or if

deflation smothers the world, then we are going to see what I term "reverse leverage." This would be an unwinding of the world's economic system with debt acting like a gigantic pair of jaws. So watch the price of oil from here on. Oil, like gold, is a barometer of inflation or deflation.

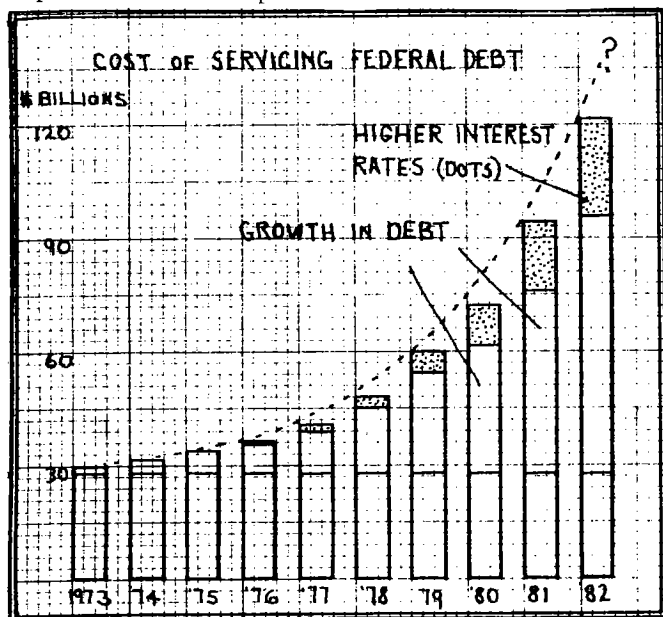
(8) The general *consensus* is that (a) we are in a long-term, big bull market in stocks. (b) Business will be appreciably better in 1983 and beyond. (c) The trend of interest rates will be generally down into the foreseeable future. (d) The world debt and deficit picture will somehow all be worked out successfully. I submit that each of these theses is open to question, and, in fact, none of them may come to pass.

(9) In twenty-five years of writing about markets, I have never seen a time when the longer-term picture was so unclear, so amenable to cross-ups and mistakes. In my guts I feel that the safest course from here on is for investors to have the bulk of their assets in US Treasury paper (notes, bills), and with some smaller percentage in gold shares and bullion and another percentage in common stocks. This is diversification, but I really think that diversification is the only way to go from this point on.

(10) It is conceivable that the picture will clarify, at least in certain areas, over the next six months to a year. But right now I can make a fairly good case for either the bull OR the bear side for almost every investment vehicle from bonds to stocks to collectibles to gold. I don't think I've ever felt this way before.

(11) As I've warned for the last few years, the forces of inflation (credits and loans) and the forces of deflation (servicing of incredible mountains of debt) are now meeting head on. This clash is far from over, but already it has given the markets a volatility and speculative intensity that has not been seen during the life of most investors. I expect this volatility to become even more spectacular as the months go by.

RISEING: Veteran subscribers know that I have been talking about the compounding effect of debt for a number of years. As of this writing (sadly), nothing has changed. Although private debt has grown far more than Federal debt, the Federal debt still presents tremendous problems.



This chart shows the rising cost of servicing the Federal debt. The chart shows two items: the yearly rise in the actual debt through budget deficits, and the further yearly rise in the debt via the cost of interest rates to carry the debt. As of this year (1982) the total cost of servicing the debt rose to over \$120 billion. Next year the deficit looks like \$150 billion, the total debt of the US will probably jump to \$1.2 trillion, and the cost of servicing that debt will probably be as big or bigger than 1982.

How can the US bring down its debt and debt costs? I know of no way short of depression. A balanced budget (or even a surplus) would mean a vast cutting of entitlements and military expenditures. Will that occur? It hardly seems likely today. Remember, all Reagan has tried to do was cut back the RATE of rising spending. I don't think he even entertains thoughts of cutting back actual spending.

So the nation has really painted itself into a corner. It is living far above its means (and income), and preserving the current standard of living requires continued borrowing. On the other hand, a drop in Federal spending means recession or depression. And the massive cost of service charges to carry the debt goes on.

This is why so many intelligent analysts believe that ultimately, when the chips are down, the Government will resort to all-out inflation in an effort to handle the problems of the debts. I'm skeptical. For if we resort to hyper-inflation the bond market is doomed. If that is the case, we will move into an era of super-high interest rates, business will collapse and a depression (brought on by sky-high interest rates) will be the result.

Conclusion: There is no painless way to either deflate or hyper-inflate. So far, the Fed has been trying to hold the line on money creation while bailing out the important basket cases one by one. These are the fundamentals, the major long-term fundamentals of this bear market. And those fundamentals can't be manipulated or erased by Presidential edicts, Congressional law or Fed action.

NOTES & QUOTES: I'm sure that I am far from the smartest guy in this business. But sometimes I think that I get more mail than anybody else in the advisory field. Periodically, I include a comment (a cry for help) stating that I can't answer all the letters. In fact, I can only answer a small fraction of the letters received here. No, don't get me wrong; I love to receive the mail, and a lot of it is very informative and interesting. In fact, I sometimes wish I could put out a second publication which would merely reprint most of the fascinating letters that come to my office each week.

For instance, I made a comment about radioactivity and cigarettes in Letter 848. As a result, I received all kinds of data, personal reports, confessions and articles from dozens of subscribers. Evidently, a lot of people are either worried about their smoking or happy about their triumphant abstention from smoking. But again, I can't answer all the letters.

I also get lots of mail whenever I make a mistake in spelling, punctuation—or worse, a mistake on a fact. But the amazing thing is that each time I include my plea not to expect answers to letters, the amount of mail received seems to grow larger. My only conclusion is that I probably should have been a politician rather than a market analyst. Something about me or my approach makes people want to write.

All right, I'll say it again. I love the letters, but I can't answer most of them. If I did answer them, I wouldn't have time for writing this report or mulling over the markets. It takes a lot of energy to answer a letter. And I feel that I owe my energy to all of my subscribers. Therefore, don't be insulted if you don't hear from me. I did read your letter, but . . .

* *

I've never been a Teddy Kennedy admirer. Kennedy is one of the wealthiest Senators and I have reason to know that Kennedy gets the best advice in many areas including economics. I thought Kennedy's announcement that he would not run for President in 1984 was interesting. My guess is that Kennedy wants no part of the Presidency in 1984. My further guess is what Reagan is dealing with now will be a lead-pipe cinch compared to what our 1984 President will have to deal with. So Teddy isn't so dumb—and he did say that he could conceivably run in 1988.

* *

The biggest force in the market today is the pension funds. Their assets at the end of 1981 were \$513 billion and probably growing at the rate of \$70 billion a year! The battle to manage (perform for) the funds, as you can imagine, is intense. It's a fiercely competitive business, and the competition in this half trillion dollar business is adding a lot of volatility to this most volatile of all stock markets. I thought the following (from the excellent "Exchange Insiders Report, PO Box 1508, Pinehurst, NC 28374) was well worth including:

To cite an extreme case, American Telephone's Pension Plan, which is the world's largest at \$39.4 billion, retains no less than 106 *competitive managers* . . . running the gamut from Morgan Guaranty, Mellon, and Harris Trust down to Eastdil Advisors, Inc. ATT is not alone. Among the top 100 pension funds, about 80% employ at least five competitive managers. Placed in this kind of pressure-cooker, the competing managers are performance crazy. They're either looking for a bigger slice of the action, or they're afraid of getting chopped off the list entirely. But, it's fear really more than greed that compels them to act like *sheep*. Surely, there's no room for mavericks in their business; it's safer to join the flock and keep the account.

TRADERS, ACCUMULATORS: It's hard to be rich. It takes a lot of talent, intensity, luck or genius to be rich. But to be reasonably well-off is not difficult. And I wish my subscribers would understand that (of course, a lot of my subscribers are well off and a goodly number are rich).

"But why bother to be rich?" you ask. And I say, "That's a personal decision. I don't know if it's worth all the effort, concentration and sweat, but I do think it's worth being well off financially. Why? Because a reasonable amount of wealth LEAVES YOU FREE. Money serves one major purpose as far as I'm concerned. It allows me to be free; it gets the world off my back".

I've seen traders by the score, I've known them by the dozens. Most of them lose their shirts. A good trader is rare, a great trader is extremely rare. In fact, I'd say a great trader is a genius in the investment field. And as you know, geniuses are very rare indeed. So my belief is that unless you are very talented, very single-minded or unless you are a genius at investing, you'll do better in the end by avoiding trading.

Now most people do try trading. And as I said, most people lose money at trading. So ultimately, they either give up trading or go broke. It seems to work that way.

If you want to make money in the markets, if you want to end up reasonably well off, then I recommend that you become an accumulator. An accumulator diversifies. He may own a home, he owns some cash, he owns gold and gold shares, he owns some Treasury notes, some bonds, and he owns or soon will own some no-load stock funds. An accumulator continues to accumulate—that's the definition of an accumulator. Just as a trader trades, an accumulator keeps putting things away.

Does timing ever effect an accumulator? I'd say yes, and it's when the great primary tide of the market turns up or down. And very frankly, it's for that reason that I originally started working on the PTI. I wanted a long-term barometer to follow, something that would tend to keep me on the right side of the market.

What about stocks? Which stock? When? Here I must say that I feel that great effort expended on picking the right stock, the stock that is going to outperform the market, that effort is basically a waste of time for 90% of investors. Why do I say that? Because you have no-load fund managers who beat their brains out, people who think, drink, eat and sleep stocks, and these people do it all for you—a lot better than you can do it yourself. Picking stocks is for traders or people on an ego trip. Buying no-load funds is for accumulators (although actually many good traders now buy and sell no-load funds).

My conclusion after 25 years of writing these reports is that the real money made by individuals tends to come from accumulating assets, not trading. If you never get another thing out of these reports, that statement should stand you in good stead. And I'll make one addition to that statement—learn about compounding interest. Study compounding tables. Compounding is the mechanism that works the magic for accumulators. Most people spend their whole investing lives unaware of the power of compounding. Yet I consider compounding the "secret ingredient" for creating wealth.

Here are a few rules for accumulators: (1) Don't buy something that is going to "go under." In order to accumulate and compound, you have to buy *safe* items. That, for instance, is one advantage of a no-load fund—it's not going to go broke. Obviously, if you are going to buy bankruptcies, you aren't going to be able to compound your money. (2) Stay very diversified. That way, if an item fluctuates in prices or drops say 15%, you're not going to be scared out of it. (3) Buy items (gold and a home are exceptions) that pay a return. No return, no compounding. (4) Be patient. Compounded wealth is produced through TIME. If you don't give it time, it isn't going to work.

Here's a view of what's happening from the New Yorker. Aw c'mon, when are you media guys going to leave Ronnie alone!



"You said that under the Reagan Administration you'd be a different person."

LATE NOTES: The Averages have been moving sideways since October. The sideways movement has broken the upward trendline drawn from the August bottom. The PTI is within 10 points of its rising trendline, and the A-D Ratio has now ruptured its rising trendline. Is this a massive top forming—or merely a consolidation preparatory to the next advance? No one, absolutely no one can know with certainty, but a breaking of Dow 980 will tell us that a top has been completed.

Actually, the stock market and the bond market have been moving as if locked together. The bonds have formed a huge toppy-looking structure, and they "feel" heavy to me. The long-term Treasuries (under pressure last week) pushed into the 11% yield zone again. If the bonds do go, you can almost bet that the stock market will go with them.

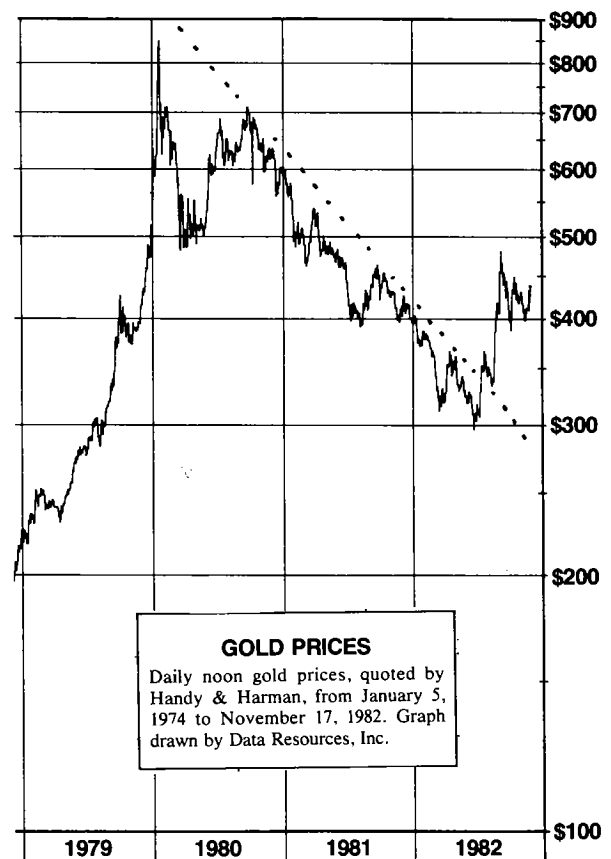
With the relative strength switch from common stocks to gold, many subscribers are asking for an easy way to participate in gold (or at least a way to hedge in gold). One easy way is via a no-load fund. One such is United Services Gold Shares (800 - 531-5777). Another is Fidelity Select Precious Metals (800 - 225-6190). Both of these funds offer switch capabilities, but for accumulators you probably should buy a certain amount of either of these funds and just put it away (or preferably sell them the next time gold blows its top). Will gold ever blow off again—as per 1980? I think it's a good bet it will.

GOLD: I've given many of the fundamentals for a bullish gold picture. So now let's get technical. The consensus (tabulated from dozens of sources) shows that 80% of the services are currently bullish on gold. That's too much bullishness. Therefore, we can expect some weakness here, some irregularity. That's the minus.

The plus is that my ratio of gold bullion to common stocks (I use the NYSE Composite for a stock proxy) has turned in favor of gold. Last week my 3-week average of the ratio pushed above the 8-week average of the ratio. That's my signal to switch out of stocks and into gold (based strictly on relative strength considerations). If gold is going to move up, this is the background which generally accompanies the move.

The three moving averages tend to work very well for gold, and they have stood us in good stead. The 50-week or primary trend MA stands at 398 this week. The 13-week or intermediate MA for gold stands at 420. And the 5-week (most sensitive) MA now sits at 431.

If gold turns irregular or sloppy (due to too many bulls and too much optimism) we can watch the downside action. If gold (on weakness) holds above the 5-week or even the 13-week MAs, that's good action. Don't forget, there are thousands of people playing gold in the futures markets now. They'll usually get knocked out of the box prior to a bull move. The bulls get defeated by scary dips or tedious sideways movements. Meanwhile, the gold shares have been tigers. ASA and Campbell are showing big profits from where I first recommended them. Sit tight with these two—and your coins. (The gold chart is from my good friend, Harry Browne's "Special Report", Box 5586, Austin TX 78763).



NEXT MAILING: Dec. 29